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SUBJECT: PROPOSED SRI LANKA 2006 BUDGET DEAD ON ARRIVAL

11. (SBU) Summary: Finance Minister Sarath Amunugama (Amunugama) presented a 2006 budget proposal of the current Government of Sri Lanka (GSL) to a less-than-packed Parliament on November 8, just 10 days before presidential elections. The main opposition United National Party (UNP) and its allied parties boycotted the presentation, describing it as a political gimmick and a hoax. Amunugama spoke of a budget to take the Sri Lankan economy towards a 6 to 8 percent growth path over the next 3 to 5 years, while still giving a little to pensioners, public servants, agricultural workers, but not much for business. The current government promised increased pensions, government salaries and subsidies, along with adjustments to numerous taxes. In a wise move (should it occur), the fuel subsidy that has cost the GSL enormously would be significantly reduced. Nevertheless, this budget will never be debated in Parliament, and Sri Lanka will endure the presentation of a new budget proposal sometime following next week's elections. End Summary.

SIGNIFICANT INCREASE IN REVENUE AND SPENDING ANTICIPATED

12. (U) Under the proposed budget, total projected revenue would be Rs. 477 billion (\$4.77 billion) with total expenditures of Rs. 671 billion (\$6.71 billion), excluding post-tsunami reconstruction expenses. Amunugama said that the budget would increase GSL revenue by Rs. 33.5 billion (\$335 million), of which Rs. 17.8 billion (\$178 million) would be used for salary increases, pension increases, community development program allowances and welfare increases. New revenue proposals introduced were expected to raise Rs. 25 billion (\$250 million) over an above the printed budget estimates.

13. (U) Extolling the government's ability to capture more tax in 2005 -- partially due to duties charged tsunami donors -- the new budget anticipates that revenue will continue increasing. Tax revenue is expected to increase by 25 percent from Rs. 345.4 billion (\$3.45 billion) to Rs. 431.8 billion (\$4.32 billion). All forms of revenue collection are expected to increase by no less than 23 percent, with the highest increase for tax on goods and services at 32 percent. These revenue figures assume a 45 to 79 percent growth in income, sales, and external trade taxes from 2004 to 2006. (Comment: A 45 to 79 percent growth rate in tax revenue would be a commendable achievement if it could be pulled off without dragging the economy. End comment.)

TSUNAMI RECONSTRUCTION EXPENSES HIDDEN

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14. (U) Tsunami-related expenditures are tucked at the bottom of a spreadsheet of budget figures prepared by the Ministry of Finance and Planning. While Amunugama spoke of a budget deficit of only 1 percent of GDP, this statistic does not include tsunami-related expenditures, which are largely funded by foreign grants and foreign borrowing. Had these expenditures been included, they would have resulted in a proposed 2006 budget deficit of 9 percent of GDP.

TAX MODIFICATIONS

15. (U) Numerous changes in taxes were proposed. Corporate tax rates for quoted companies would rise from 30 percent to 33.3 percent, while tax on financial services would rise from 15 percent to 20 percent. Other tax hikes would be placed on gambling, tobacco and liquor. Amunugama also proposed bringing back a stamp duty on all financial transactions, targeted at increasing government revenue by about Rs. 3.7 billion (\$37 million).

16. (U) In contrast, taxes on computers, mobile phones and motorbikes would be reduced or eliminated. Duty and VAT exemptions on imports of large construction machinery and equipment would be granted for the next two years under the proposal.

OIL SUBSIDY WOULD BE REMOVED: A WISE MOVE

17. (U) Amunugama also proposed to remove the fuel price subsidy and return to an automatic fuel price formula. "Recurrent expenditure remains vulnerable to rising oil cost if we do not remove our fuel subsidy," said Amunugama. "Therefore, fuel subsidy will be limited to Rs. 3,000 million (\$30 million) in the Budget and fuel prices will be adjusted in line with formula prices next year." In 2004, the GSL spent Rs. 20 billion (\$200 million) on fuel subsidies, and a similar amount is expected for 2005. The proposal would provide subsidies only to portions of the transportation sector, fisheries, and rural poor who do not have electricity.

ENTICING PROGRAMS PROPOSED

18. (SBU) More interesting for most Sri Lankans than tax changes (unless buying a computer or motorbike over the next year) were the multitude of spending programs. From increases in government pensions and living allowances, tax cuts to public servants purchasing vehicles, to widows who wish to remarry while continuing eligibility to receive "Widows and Orphans Pensions," the budget seemed to offer at least a little to just about everyone either on the government payroll or on what dole exists in Sri Lanka. Several other proposals involved infrastructure projects (some funded by the USG or other donors), development of the cashew industry, prawn farming, promotion of deep-sea fishing, textile, giftware, upmarket tourism, and printing and packaging industries. Noting that Sri Lanka must position itself as a "knowledge economy," Amunugama said that Sri Lankans must become "professional service providers both within and outside our country." Yet details of how to further this goal were scant.

AN ELECTION TOOL AND A "HOAX?"

19. (U) Describing it as a political gimmick and a hoax, the main opposition UNP and its allied Ceylon Workers Congress, Sri Lanka Muslim Congress, and Upcountry People's Front parties boycotted the presentation. Chief opposition Whip Mahinda Samarasinghe announced that the UNP would unveil its budget after its "leader Ranil Wickremesinghe Wickremesinghe is elected President."

10. (SBU) In the buildup to the presidential election, neither of the two main candidates has ever had a clear lead. Many continue to believe that next week's election is extremely close. Reportedly, a large number of voters are still undecided. The UNP, as well as other observers, speculated that the budget proposal would be merely a political tool to sway undecided voters toward the current Prime Minister, Sri Lanka Freedom Party (SLFP) candidate Mahinda Rajapakse.

ANOTHER BUDGET PROPOSAL PROBABLY FORTHCOMING

11. (SBU) The proposed budget must pass Parliament before next week's presidential elections for it to determine the GSL's fiscal direction in 2006. Since it will not come up for debate prior to the election, the budget was dead on arrival, which may explain why it included politically-suicidal items like ending the gasoline subsidy.

12. (SBU) Comment: This budget proposal could be viewed in at least two ways: a vote-catching move by the government, or a stab at defining the way the government would have gone if the current administration could have stayed in power for an additional year. It may be a little of both. Nevertheless, we will undoubtedly report soon on another budget proposal, one that may be quite different from this week's proposal.

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